

Message Text

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ACTION FS-01

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TAGS: EFIN, MX
SUBJECT: VALUE OF MEXICAN PESO

1. SUMMARY. RUMORS OF ANOTHER DEVALUATION OF THE MEXICAN PESO ARE CIRCULATING. SUCH FEARS SEEM TO BE BASED ON MEXICO'S HIGH CURRENT RATE OF INFLATION. ALTHOUGH THE PESO MAY BE SLIGHTLY OVERVALUED, THE COUNTRY'S FOREIGN EXCHANGE POSITION CONTINUES TO BE STRONG AND IT APPEARS THAT THE GOM PREFERS TO PURSUE A POLICY OF MAINTAINING THE RATE AT A STEADY LEVEL OR AT MOST WITH ONLY MINOR MOVEMENTS. END SUMMARY.
2. RUMORS OF PESO DEVALUATION: RUMORS ARE CURRENT AMONG BUSINESSMEN AND BANKERS THAT THE MEXICAN PESO WILL SOON BE DEVALUED AGAIN. THESE RUMORS SEEM TO BE EMANATING FROM PRIVATE BANKING CIRCLES, BOTH MEXICAN AND FOREIGN. THE REASON USUALLY GIVEN FOR FURTHER DEVALUATION IS THE RAPID RATE OF INFLATION MEXICO IS EXPERIENCING. BUSINESS EXECUTIVES TELL US THAT THEY ARE INCLUDING A FACTOR OF UP TO 10 PERCENT FOR PESO DEPRECIATION IN THEIR CORPORATE PLANNING FOR THE REST OF 1978 AND 1979. THE GOM IS AWARE OF THE UNEASINESS OVER THE EXCHANGE RATE AND LAST WEEK ROMERO KOLBECK, DIRECTOR

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GENERAL OF THE BANK OF MEXICO, STATED THAT THE PESO WOULD NOT BE DEVALUED AND IT WOULD CONTINUE TO BE CLOSELY LINKED TO THE DOLLAR. KOLBECK ALSO SAID THAT THE BANK OF MEXICO HAD TOTALLY LIQUIDATED THE IMF'S "SUPPLEMENTARY FACILITY" IN ADVANCE OF THE DUE DATE.

3. INFLATION IS INDEED HIGH IN MEXICO, COMPARED TO THAT

OF THE U.S. WITH WHOM IT CONDUCTS ALMOST TWO-THIRDS OF ITS TRADE. THE AVERAGE ANNUAL RATE OF INCREASE FOR THE WHOLESALE AND CONSUMER PRICE INDICES IS RUNNING AT 23.2 PERCENT AND 19.9 PERCENT RESPECTIVELY. COMPARABLE AVERAGE U.S. INFLATION RATES FOR THE SAME PERIOD ARE 11.9 AND 8.1 RESPECTIVELY. THE RATE OF MEXICAN PRICE INCREASES IS NOT SURPRISING GIVEN THE FACT THAT THE MONEY SUPPLY HAS BEEN EXPANDING SINCE EARLY 1977 AT A 26-28 PERCENT ANNUAL RATE, ALTHOUGH THE RATE OF EXPANSION HAS SLOWED IN LAST FEW MONTHS.

4. FOREIGN EXCHANGE RESERVES: DUE LARGELY TO THE STABILIZATION PROGRAM, SOME CAPITAL REFLAWS, INCREASING PETROLEUM REVENUES AND CONTINUED EXTERNAL BORROWING THE BANK OF MEXICO HAS BEEN ABLE TO MAINTAIN THE EXCHANGE RATE AT ABOUT 22.8 PESOS PER DOLLAR AND AT THE SAME TIME BUILD UP RESERVES. IT GAINED OVER 470 MILLION DOLLARS OF RESERVES DURING 1977 AND 33 MILLION DOLLARS IN THE FIRST HALF OF 1978. THIS IMPROVED FOREIGN EXCHANGE POSITION HAS HELPED TO REDUCE PRESSURES FOR FURTHER DEVALUATION.

5. FOREIGN BORROWING: A SLOWDOWN IN THE PACE OF EXPANSION OF EXTERNAL INDEBTEDNESS ALSO HAS FACILITATED THE GOM'S RECENT EXCHANGE RATE POLICIES. NET PUBLIC SECTOR MEDIUM AND LONG-TERM EXTERNAL BORROWING IN 1977 WAS ABOUT \$3 BILLION, AND GOM AND ITS AGENCIES WILL LIMITED OFFICIAL USE

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BORROW 3 BILLION DOLLARS NET AGAIN THIS YEAR, RAISING THE GOM'S TOTAL FOREIGN INDEBTEDNESS TO ABOUT 26 BILLION DOLLARS BY THE END OF 1978. IN BOTH YEARS THE FIGURES ARE WITHIN THE GUIDELINES OF THE STABILIZATION PROGRAM AND OVER THE NEXT TWO YEARS GOM OFFICIALS BELIEVE THAT NET EXTERNAL BORROWING WILL NOT HAVE TO INCREASE AND PERHAPS MAY EVEN DECREASE. THE GOM IS CONTRACTING AND RESCHEDULING DEBT INTO THE 1980'S WHENEVER POSSIBLE WHEN ITS FOREIGN EXCHANGE REVENUES FROM PETROLEUM WILL BE MORE FULLY ONSTREAM.

6. MEXICO A GOOD CREDIT RISK: PRIVATE BANKS AS WELL AS IFI'S CONSIDER MEXICO A GOOD CREDIT RISK. THE AVERAGE SPREAD OVER LIBOR FOR PRIVATE EURODOLLAR LOANS HAS DROPPED FROM ABOUT 1.6 - 1.7 PERCENT IN 1977 TO 1.3 AND 1.1 IN THE FIRST AND SECOND QUARTERS RESPECTIVELY OF 1978, AND THE GOM IS NEGOTIATING A 500 MILLION, FIVE-YEAR, SINGLE REPAYMENT LOAN FOR BANRURAL AT ONLY ONE PERCENT OVER LIBOR. ALSO THE FEBRUARY 1978 LOAN FOR ONE BILLION DOLLARS HAS A FOUR-YEAR GRACE PERIOD BEFORE THE SIX-YEAR PERIOD OF REPAYMENT STARTS. UKLPO(3\$/589\$FVTAN BANKERS ARE INCREASINGLY CONFIDENT THAT MEXICO WILL HAVE

LITTLE TROUBLE IN COMING UP WITH THE NECESSARY FOREIGN EXCHANGE TO MEET ITS EXTERNAL OBLIGATIONS, PRIMARILY THROUGH PETROLEUM AND GAS EXPORTS.

7. CONCLUSION: ALTHOUGH THERE ARE SOME PRESSURES FOR DEVALUATION BASED UPON RELATIVE INFLATION RATES AND THE BHHDED TO MAINTAIN EXPORT COMPETITIVENESS, THE GOM APPARENTLY STILL BELIEVES THAT CONTINUED RESTORATION OF INVESTOR CONFIDENCE AND INDUCEMENT OF INVESTMENT AND CAPITAL REFLOWS IS A HIGHER PRIORITY. MOREOVER, AS LONG

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AS ITS TRADE BALANCE DOES NOT DETERIORATE TOO BADLY THIS YEAR, AND THE BUDGET DEFICIT DOES NOT EXPAND EXCESSIVELY, THE GOM SHOULD BE ABLE TO CONTINUE THIS POLICY IF IT SO DESIRES. THUS, ALTHOUGH THERE MAY BE SOME MINOR FLUCTUATIONS, WE DO NOT ANTICIPATE ANY MAJOR MOVEMENTS IN THE EXCHANGE RATE, AT LEAST OVER THE NEXT FEW MONTHS. LUCEY

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